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The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
395 E Street, S W
Washington, D.C. 20423-0001

Re: Finance Docket No 42095, Kansas City Power & Light Company v Union Pacific Railroad Company

Dear Mr. Williams:

Enclosed for filing in the above-referenced docket please find an original and ten copies of Union Pacific's Opening Evidence, along with three electronic copies on 3.5-inch IBM-compatible formatted floppy diskettes.

Also enclosed please find three sets of Union Pacific's electronic workpapers on compact discs. The electronic workpapers should be treated as Highly Confidential, pursuant to the Board's Protective Order in this proceeding.

An additional paper copy of Union Pacific's Opening Evidence is also enclosed. Please return a date-stamped copy to our messenger

Thank you for your attention to this matter.

Sincerely

Michael L. Rosenthal

Enclosures

cc: Kelvin J. Dowd, Esq. (by hand)

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BEFORE THE
SURFACE TRANSPORTATION BOARD

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KANSAS CITY POWER & LIGHT COMPANY,	)	
Complainant,	)	
v.	)	Docket No. 42095
UNION PACIFIC RAILROAD COMPANY,	)	
Defendant.	)	

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UNION PACIFIC'S OPENING EVIDENCE

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July 30, 2007

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BEFORE THE
SURFACE TRANSPORTATION BOARD

KANSAS CITY POWER & LIGHT COMPANY, Complainant, v. UNION PACIFIC RAILROAD COMPANY, Defendant	)))))))))))	Docket No 42095

UNION PACIFIC'S OPENING EVIDENCE

Union Pacific Railroad Company ("UP") hereby submits its opening evidence in compliance with the Board's Order served May 4, 2007. UP submits this evidence in the format prescribed in *General Procedures for Presenting Evidence in Stand-Alone Rate Cases*, STB Ex Parte No. 347 (Sub-No. 3) (STB served Mar. 12, 2000).

UP's opening evidence demonstrates that the Board must dismiss the complaint in this proceeding because the challenged rates fall below the jurisdictional threshold established in 49 U S C. § 10707(d)(1)(A).

I. COUNSEL'S ARGUMENT AND SUMMARY OF EVIDENCE

A. INTRODUCTION

Kansas City Power & Light Company ("KCPL") challenges the reasonableness of UP's rail transportation rates for the movement of coal from the Powder River Basin ("PRB") to KCPL's Montrose Generating Station near Ladue, Missouri ("Montrose"). UP's rates were established in Item 4140 of Circular 111, which became effective on January 1, 2006.

The UP rates that KCPL is challenging cover the entire route from the PRB to Montrose UP is the only carrier that is a party to the challenged rates and is solely responsible to KCPL for delivering the issue traffic to Montrose. However, UP does not physically serve Montrose. In December 1992. UP entered into a Lease Agreement with Missouri & Northern Arkansas Railroad Company ("MNA").[1] Under that agreement, UP leased to MNA certain lines, including its lines between Montrose and Pleasant Hill, Missouri. In separate agreements, UP granted MNA trackage rights between Pleasant Hill and Kansas City, Missouri, and established arrangements that allow the railroads to interchange traffic in Kansas City. In the lease, MNA agreed to handle UP's coal traffic between Kansas City and Montrose for a fixed charge per loaded car. UP agreed to provide locomotives for MNA's movement of unit coal trains to Montrose at no cost to MNA. KCPL did not name MNA as a defendant in this case

UP has narrowed the scope of this case substantially. For purposes of this case, UP has waived its right to present stand-alone cost evidence and has stipulated that if the Board finds it has jurisdiction to regulate the challenged rates, the maximum reasonable rates are 180 percent of variable costs, properly calculated *See* Joint Stipulation and Procedural Schedule, filed Apr. 18, 2007. UP also has waived its right to contest whether there is qualitative evidence of effective competition from other carriers or modes of transportation for the transportation to which the rates apply *See id*

In addition, the parties have agreed on the nine inputs for the URCS Phase III program to calculate variable costs for each origin-destination pair in each calendar quarter that

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1 The MNA Lease Agreement and relevant amendments were produced to KCPL in discovery and are included in UP's electronic workpapers. *See* Electronic workpaper "MNA_Lease pdf."

was completed as of the Board's May 4 Order, *if* the issue traffic properly could be treated as an interline movement with MNA's variable costs as the appropriate measure of the variable costs of handling the traffic between Kansas City and Montrose. *See* Joint Submission of URCS Phase III Operating Characteristics, filed June 8, 2007.[2] That approach appears to be consistent with KCPL's view. *See id* at 4. However, UP believes that MNA's variable costs are irrelevant and that a proper calculation of the relevant variable costs must include UP's payment to MNA, which is not captured as a cost in URCS. *See id* at 3.[3]

Accordingly, UP believes that the only significant disputed issue that remains in this case is how to calculate properly the variable costs for handling the issue traffic between Kansas City and Montrose on the MNA.

B. THE BOARD LACKS JURISDICTION OVER THE CHALLENGED RATE.

If the Board properly calculates UP's variable costs for providing transportation services between the PRB and Montrose, the challenged rates will result in revenue-to-variable cost ratios that are below 180 percent. *See* Exhibit A.

Calculating UP's variable costs properly is a straightforward process:

First, the Board must calculate UP's variable costs for the portion of the route between the PRB and Kansas City. UP's variable costs for the PRB-Kansas City portion of the route should be based on UP costs calculated using the Uniform Rail Costing System ("URCS").

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2 The Joint Submission is included in UP's electronic workpapers. *See* Electronic workpaper "Joint_Submission.pdf."

3 In the Joint Submission, KCPL submitted data regarding cycle times and tare weights for the private cars utilized in KCPL service. UP consented to the inclusion of those data in order to avoid unnecessary disputes, but UP does not agree that they may be used in this proceeding to adjust the results of the Phase III program and has not reviewed them for accuracy. *See* Joint Submission at 3.

Second, the Board must calculate UP's variable costs for the portion of the route between Kansas City and Montrose. The Board cannot rely solely on UP's URCS costs for this calculation because UP provides only the locomotives and fuel. UP has arranged with MNA to provide the other services necessary to move the issue traffic to Montrose in return for a fee UP pays on a per-carload basis, and as the Board has recognized, UP's payment to MNA is not captured as a cost in URCS *See Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 57 (STB served Oct. 30, 2006) ("*Major Issues*") Thus, to calculate UP's variable cost for the Kansas City-Montrose portion of the route, the Board should calculate UP's variable costs of providing locomotives and fuel using URCS system-average costs and add the per-car payment that UP makes to MNA.

The Board would have followed this process prior to its October 2006 decision in *Major Issues*. Thus, if the Board were to evaluate the challenged rates under the standards that applied when UP established the challenged rates, KCPL's complaint would be dismissed.

However, UP recognizes that the Board may not be inclined to follow this process in light of its decision in *Major Issues*. In *Major Issues*, the Board ruled that "[t]he variable costs used in rate reasonableness proceedings will be the system-average variable cost generated by URCS, using the nine movement-specific factors inputted into Phase III of URCS." Slip op. at 60. The Board's ruling rejected more than two decades of precedent holding that payments of the type that UP makes to MNA are legitimate costs that must be included in variable cost calculations. *See, e g.*, *Pub Serv Co of Colo v Burlington N &S F. Ry*, STB Docket No. 42057, slip op. at 143 (STB served June 8, 2004), *Carolina Power & Light Co v Norfolk S. Ry*, STB Docket No. 42072, slip op. at 129 (STB served Dec. 23, 2003); *Tex Mun Power Agency v Burlington N &S F Ry*, 6 S.T.B. 573, 642 (2003); *FMC Wyo Corp v Union Pac R R.*, 4 S.T.B.

699, 760-61 (2000); *Pielet Bros Trading Co v Chicago & N W Transp Co*, ICC Docket No. 39756, at 3 (ICC served Aug. 11, 1987); *Petition of Denver & R G W R R & Salt Lake, G & W Ry for Review of a Decision of the Pub Serv Comm'n of Utah Pursuant to 49 U S C. 11501*, ICC Docket No 39060, at 8-9 (ICC served Nov. 14, 1985), *aff'd in relevant part sub nom Utah Power & Light Co v ICC*, 747 F.2d 721, 740-41 (D.C. Cir. 1984).

The Board made this dramatic reversal even though none of the participants in the proceeding urged that outcome. The Board apparently based its decision to exclude these "third-party costs" on its belief that they were no different from other movement-specific adjustments to URCS that parties had argued about in past cases and that, like those other adjustments, "their inclusion in URCS variable costing analysis clearly consumes an inordinate amount of resources of the parties and the agency, and may bias the entire variable cost calculation" *Major Issues*, slip op. at 60.

UP and other participants have appealed this and other aspects of the decision in *Major Issues*. However, UP submits that, regardless of the outcome of that appeal, the Board should re-examine its conclusions regarding third-party costs in the context of a concrete case because its conclusions are wrong and will undermine the national policy "to ensure the development and continuation of a sound rail transportation system." 49 U.S.C. § 10101(4) Even if the Board does not re-examine its overall conclusions, it should rule that they do not apply to this proceeding in light of the circumstances surrounding UP's payments to MNA.

In the sections below, we demonstrates that: (i) the Board would have treated UP's payments to MNA as variable costs under the law as it existed before *Major Issues*; (ii) the Board's justifications for prohibiting movement-specific adjustments to URCS do not apply to the treatment of UP's payments to MNA as variable costs; (iii) the alternatives to treating UP's payments to MNA as variable costs are flawed and will produce inaccurate results; and (iv) the Board's statement in *Major Issues* that parties can request rulemakings to improve URCS is not a reasonable answer to the issues raised here by UP.

1. The Board Would Have Treated UP's Payments to MNA as Variable Costs Under the Law as It Existed Before *Major Issues*.

Under the law as it existed before *Major Issues*, a defendant's payments to a third party for handling issue traffic over a portion of the issue route were treated as variable costs if the defendant was "ultimately responsible" for delivering the traffic. *FMC*, 4 S.T.B. at 760.

This case fits squarely within that precedent UP remains ultimately responsible to KCPL for delivering the issue traffic to Montrose, even though MNA physically delivers the traffic to Montrose UP's responsibility to KCPL is established by the challenged tariff.[4] Under the tariff, UP is solely responsible for delivering the traffic in accordance with the service commitments in the tariff unless the traffic is interline traffic. *See* Option 2, Part II.D ("[I]f Rate Item applies only to the UP portion of an interline route, UP shall not be responsible for delays attributable to connecting carrier's inability to accept trains at interchange or delays on the connecting carrier's portion of the route ") In this case, the rate item does not identify the traffic as interline traffic. *See* General Rule Item 5, Rate Item 4140 In summary, because the challenged rate item and service commitment applies to the entire route, UP is ultimately responsible for delivering the issue traffic to KCPL, even if a service failure occurs on the MNA

UP's acceptance of responsibility is more than a paper commitment KCPL was a UP customer when UP entered the MNA lease, and UP and MNA structured the lease so that UP could make good on its then-existing commitments to KCPL. The lease imposes specific

[4] The challenged tariff is included in UP's electronic workpapers. *See* Electronic workpaper "KCPL_Tariff pdf "

maintenance requirements on MNA and gives UP the right to inspect the premises and order repairs *See* MNA Lease §§ 6.01, 6.02. UP can terminate the lease if MNA fails to make the required repairs. *See id* §§ 15.04, 19.01(c). The lease also prohibits MNA from suspending or discontinuing operations without regulatory authority and requires it to relinquish possession of the premises to UP if it obtains regulatory authority to suspend operations. *See id* §§ 3 02, 3.03 In addition, shortly after UP and MNA entered into the lease, they agreed to modify its terms, at KCPL's request, to allow UP rapidly to obtain trackage rights over or enter the leased lines if MNA is unable to provide service to Montrose. *See id*, Second Supplemental Agreement § 1.

In past proceedings involving payments to third parties, shippers have sometimes argued that such arrangements reflect efforts to increase the carrier's variable costs in advance of a rate case through "gaming." KCPL cannot plausibly make such allegations in this case. UP and MNA entered into the lease agreement in 1992, more than a decade before KCPL filed its complaint Moreover, UP's lease of its lines between Pleasant Hill and Montrose was only one piece of a much larger transaction that involved many lines that were either sold or leased, many commodities other than coal, and many shippers other than KCPL. *See Missouri & Northern Arkansas R R Lease, Acquisition & Operating Exemption – Missouri Pacific R R. & Burlington Northern R R*, ICC Finance Docket No. 32187 (ICC served Dec 22, 1992).

In addition, UP has taken ultimate responsibility to KCPL for delivering cars to KCPL since it entered into the lease in 1992. Before entering into the lease, UP provided KCPL with assurance that the lease would not alter their relationship, stating that it would "continue to sign contracts and will continue to bear sole responsibility for the remedies and recoveries activated by the delivering carrier's failure to meet applicable contract terms."[5] Moreover, as discussed above, UP structured the lease to fulfill its commitments to KCPL and even modified the lease to address concerns expressed by KCPL. Finally, KCPL recognized that its relationship was with UP, not MNA, and that UP had the ability to meet its service commitments. For example, the contract that governed transportation of coal to Montrose from 1995 through 2005 was between KCPL and UP and did not even mention MNA.[6] KCPL did not name MNA as a defendant in this proceeding, presumably in recognition that this is not a joint rate and that UP holds itself out as providing the service.

2. The Board's Justifications for Prohibiting Movement-Specific Adjustments to URCS Do Not Apply to UP's Payments to MNA.

In *Major Issues*, the Board based its decision to end the use of movement-specific adjustments to URCS on its belief that "the use of movement-specific adjustments is inordinately complex, time consuming, and expensive, and does not necessarily result in more reliable results than using URCS system averages." Slip op. at 60. The Board also believed its decision would not result in a significant difference in overall R/VC calculations. *See id.* at 53.

The Board's conclusions may be correct with respect to many of the movement-specific adjustments parties have disputed in past rate cases, but not with respect to treatment of UP's payments to MNA as a variable cost.

First, unlike the actual "movement-specific adjustments" to URCS that the Board addressed in *Major Issues*, treating UP's payments to MNA as a variable cost does not require

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5 The correspondence between UP and KCPL is included in UP's electronic workpapers. *See* Electronic workpaper "KCPL_Correspondence.pdf."

6 The contract is included in UP's electronic workpapers. *See* Electronic workpaper "KCPL_Contract.pdf."

complex adjustments to URCS system-average costs or system-average operating characteristics embedded in the Phase III program – indeed, it requires no adjustments to system-average costs or operating characteristics. UP is not arguing that the cost of operating KCPL trains is above or below system-average costs or that the KCPL trains use relatively more crews or have relatively longer cycle times than system-average trains. Treating UP's payments to MNA as a variable cost involves taking into account costs that are "not captured as costs in URCS" *Id* at 57. Accordingly, it does not raise the problem with making movement-specific adjustments to URCS that concerned the Board in *Major Issues* – the "selective replacement of system-average costs" that "may bias the entire analysis, rendering the modified URCS output unreliable." *Id* at 52

Second, treating UP's payments to MNA as a variable cost would be neither time consuming nor expensive. Discovery costs are insignificant because KCPL has known about MNA's role in handling the issue traffic since UP leased its line to Montrose in 1992, and the payment terms are set forth in the lease and its amendments. Including UP's payments to MNA in variable cost calculations does not involve any time-consuming or expensive analysis. Once UP's other variable costs have been calculated using the URCS Phase III program, nothing more than basic addition is required to account for the payment to MNA. Accordingly, treating the payments as a variable cost does not implicate the Board's concern about adjustments requiring "[m]assive discovery" or "exhaustive analysis of the reliability of the evidence." *Id* at 50.

Third, treating UP's payments to MNA as a variable cost will necessarily produce more accurate results than using only URCS system-average costs. As the Board has recognized, when a railroad pays another party to provide a service that the railroad is ultimately responsible for supplying, "the expenses it incurs to provide these services are legitimate costs." *FMC*, 4 S T.B. at 760. As discussed below in more detail, there is no alternative method of accounting for these legitimate costs that UP incurs to provide service to KCPL that possibly could be as reliable or as accurate as using the actual amount UP pays MNA. Accordingly. although many of the movement-specific adjustments the Board has permitted in the past "do[] not necessarily result in more reliable results than using URCS system averages," *Major Issues*, slip op. at 60, treating the payments to MNA as a variable cost will necessarily produce more reliable results than any alternative.

Fourth, excluding UP's payments to MNA from variable cost calculations not only would be wrong in principle, but also would have a significant impact on the variable cost calculations in this case. There is a 13-percent difference between variable costs calculated using the method that properly reflects the transportation service provided by UP and the method that UP suspects that KCPL will use – *i e* , treating the issue traffic as involving an interline movement and costing the MNA portion using Western Region URCS system-average costs. *Compare* Exhibit A *with* Exhibit B The difference is too large to ignore It is much larger than the 1-3 percent differential that the Board had in mind when considering the impact of its decision to rely solely on the URCS Phase III program *See Major Issues*, slip op. at 53.

3. The Alternatives to Treating UP's Payments to MNA as Variable Costs Are Conceptually Flawed and Will Produce Flawed Results.

If the Board does not treat UP's payments to MNA as variable costs, it must use some alternative method to calculate the total variable costs of transporting the issue traffic over the portion of the route between Kansas City and Montrose. The Board's decision in *Major Issues* that variable costs are to be calculated using URCS system-average costs and the Phase III program does not provide the answer, because the issue traffic does not involve a typical single-line or interline movement, and it involves costs that are not included in URCS. In other words, the URCS Phase III program was not designed to calculate and does not account for the costs of movements like the issue movement, so a solution that relies solely on URCS and the Phase III program is the costing equivalent of forcing a square peg into a round hole.

As we discuss below, the two most obvious costing alternatives that rely solely on URCS and the Phase III program are conceptually flawed and plainly will produce less accurate results than the established, straightforward, and accurate approach of treating UP's payments to MNA as a variable cost.

The Single-Line Alternative One alternative might be to treat the issue traffic as a single-line movement between the PRB and Montrose and cost it using only UP URCS system-average costs. However, this alternative has at least three significant problems. *First*, most elements of the service between Kansas City and Montrose are provided by MNA, not UP, and thus the costs are not reflected in the accounts that are used to develop UP's URCS. *Second*, because MNA, not UP, provides most of the services, the costs of those services cannot be measured accurately using UP URCS, which are calculated based on UP operations and costs. *Third*, UP and MNA incur significant costs to interchange the issue traffic in Kansas City, as UP illustrates below in Section II, which describes the handling of the issue traffic, and costing the movement as though it were a single-line movement would ignore those interchange costs

In short, costing the movement as though it were a UP single-line movement would ignore the basic operational fact that it is not a UP single-line movement and the costs associated with that basic operational fact. It would also substitute an artificial, URCS-based measure of UP's variable cost for the Kansas City-Montrose portion of the route for the actual variable cost incurred by UP – *i e* , UP's payments to MNA

KCPL may argue that the movement should be treated as a single-line movement because it should not have to pay for UP's decision to enter into a lease with MNA, but there is no evidence that variable costs would have been lower if UP had never leased the line to MNA. As discussed above, the MNA lease was part of a broader transaction that reduced UP's system-average costs by installing MNA as the operator of low-density lines and, through line sales, by removing road property from UP's asset base.

The UP/MNA Alternative A second alternative might be to treat the issue traffic as interline traffic with an interchange in Kansas City, deem UP's payment to MNA to be a division, and calculate MNA's variable costs using Western Region URCS As reflected in the Joint Submission of URCS Phase III Operating Characteristics, KCPL advocates this approach. But this alternative also has at least three significant flaws. *First*, MNA's variable costs are irrelevant. UP is the only party to the challenged rate, and it is responsible to KCPL for delivering the issue traffic to Montrose, and thus the rate should be assessed in relation to UP's variable costs, which include the MNA payment, not some measure of MNA's variable costs. *Second*, treating the challenged rate as if MNA were a party to a rate and received a division would be grossly unfair to UP. In a case involving joint rates, each defendant's costs are relevant because each defendant is responsible for delivering the issue traffic and may be required to pay reparations and may be bound by a rate prescription. Here, UP will bear the full impact of any reparations order and rate prescription UP's payment to MNA will be unaffected because it is established by contract *Third*, Western Region URCS costs are not an appropriate measure of the cost to move the issue traffic between Kansas City and Montrose. UP's payment to MNA is a direct, accurate measure of the relevant cost.

In short, costing the movement as an interline movement would ignore the actual relationships among UP, MNA, and KCPL.[7] It also would introduce an irrelevant factor into the costing equation – the variable costs incurred by MNA – and measure those costs using a wholly artificial standard, Western Region URCS. This artificial methodology would be no easier, and far less accurate, than measuring the actual variable costs incurred by UP – *i.e.*, UP's payments to MNA.

* * *

The Board cannot ignore variable costs involved in transporting the issue traffic from Kansas City to Montrose, but it should not develop an artificial URCS-based proxy for those costs when it is just as easy and far more accurate to measure those costs directly. Any effort to substitute some measure based on the URCS Phase III model will necessarily be less accurate and less reliable than simply using the cost that UP actually incurs to provide the service.

4. The Board Cannot Ignore the Issues Raised by UP Simply Because UP Could Request a Rulemaking to Improve URCS.

In *Major Issues*, the Board suggested that if any party disagreed with its decision because it believed URCS was flawed, it could request separate rulemakings to improve URCS. *See Major Issues*, slip op. at 61. However, that possibility does not provide a solution to the problems identified in this case for at least three reasons.

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[7] Indeed, treating the rate as a joint rate would also ignore the legal consequences of the parties' relationships. If MNA is to be treated as a party to the rate, it should be a defendant in this case, and because KCPL did not name MNA as a defendant, the Board would have to dismiss the case.

First, the problems in this case do not involve flaws in URCS – they involve the potential misuse of URCS system-averages and the Phase III program to account for costs that are "not captured as costs in URCS " *Id* at 57.

Second, modifying URCS to capture UP's payments to MNA and similar payments would not significantly improve variable cost calculations in this case. URCS spreads system-wide costs across system-wide traffic, so the payment would be diluted to the extent it would have almost no effect on the outcome in this case. Moreover, capturing the costs would not solve the conceptual problem that the traffic is neither single-line nor interline traffic. as those concepts are applied in the Phase III program.

Third. if the Board could modify URCS and the Phase III program so that they would account directly for payments such as UP's payments to MNA in an appropriate case, there should be no barrier to adopting that solution in this case. Board precedent has long-recognized that these payments are legitimate variable costs – there is no need for a special rulemaking to re-establish that point. Moreover, contrary to the Board's suggestion in *Major Issues* that any changes to URCS variable cost calculations require a rulemaking, the Board previously has modified URCS variable cost calculations without engaging in rulemakings. Only a few years ago, for example, the Board apparently determined that it was no longer accurate to use an intermodal load factor of 1.8 intermodal units per rail car in its variable cost calculations and informally asked the carriers to provide carrier-specific information to replace the prior factor. The Board has subsequently applied the new. carrier-specific load factors in its variable cost calculations. The flexibility to adopt improvements to variable costing calculations using an informal process is important in light of the resources necessary to proceed by way of a rulemaking. *Cf Review of the General Purpose Costing System*, 2 S.T.B. 659, 662 (1997) ("As for the other changes that were proposed . . ., we conclude either that the record does not support the proposed changes or that resources are not available to undertake the studies needed to implement the proposed changes. Finally, for lack of resources, we discontinue the broader effort to revise and update the URCS regression equations.")

C. CONCLUSION

In *Major Issues*, UP strongly supported the Board's efforts to simplify variable cost calculations. UP agrees that making "movement-specific adjustments" to URCS costs and the system-average operating characteristics used in the Phase III program is often "inordinately complex, time consuming, and expensive, and does not necessarily result in more reliable results than using URCS system averages." Slip op. at 60.

However, treating UP's payments to MNA as a variable cost is a different matter. UP's proposed approach is consistent with the Board's overall approach in *Major Issues*. UP's proposed approach would use URCS and the Phase III program whenever possible. But it is not possible to use URCS and the Phase III program to calculate all of UP's costs between Kansas City and Montrose – at least not without treating that portion of the route as something it is not and ignoring the most simple, straightforward, and indisputably accurate measure of UP's actual variable costs.

II. MARKET DOMINANCE

The Board may regulate the reasonableness of a challenged rate only if a carrier has market dominance over the traffic involved. *See* 49 U.S.C § 10701(d)(1), 10707(b) & (c). By definition, a carrier does not have market dominance when the revenues produced by the movement at issue are less than 180 percent of the variable costs to the carrier of providing the service. *See id* § 10707(d)(1)(A). For the purposes of this proceeding, UP has waived its right to contest whether there is qualitative evidence of effective competition from other carriers or modes of transportation for the transportation to which the rates apply.

A. QUANTITATIVE EVIDENCE.

This section of the Narrative describes the calculation of the variable costs that UP incurs to transport coal for KCPL from the PRB to Montrose. It describes the movement of KCPL coal trains to Montrose, sets forth the operating characteristics required to calculate UP's variable costs of handling the issue traffic using two approaches: (i) the approach that produces accurate variable cost calculations – *i e* , treating UP's payments to MNA as a variable cost, and (ii) the approach KCPL advocates – *i.e.*, costing the MNA portion of the movement using Western Region URCS. Finally, this section summarizes the variable cost and jurisdictional threshold calculations for the issue traffic.

The variable cost evidence presented in this section of the Narrative is supported by Benton V. Fisher, Robert J. Plum, III, and Warren C Wilson. The witnesses' verifications, which are set out in Section IV to this Narrative, describe the portions of the Narrative that each witness sponsored and each witnesses' qualifications. As described further in the verifications, Mr Fisher is a Senior Managing Director at FTI and specializes in the economic and financial analysis of network industries, including rail transportation. Mr. Fisher is UP's principal variable cost witness in this proceeding Mr Plum is a Managing Director at FTI and specializes in the economic and financial analysis of railroad operations. Mr Plum is sponsoring evidence relating to UP's operations for the issue movement Mr Wilson is UP's Senior Director Rail Line Planning and is responsible for UP's relationships with shortline and regional railroads. Mr. Wilson is sponsoring evidence relating to UP's lease agreement with MNA.

1. Variable Costs

KCPL challenges the reasonableness of UP rates published in Item 4140 of UP Circular 111 for transportation of PRB coal to Montrose, which became effective on January 1, 2006. The rates in Item 4140 apply to movements in shipper-provided cars with a minimum lading weight of 117 tons per car and a minimum tender per shipment of 12,285 net tons per train Item 4140 also provides that the rates are subject to a fuel surcharge, and it includes a service commitment that allows UP to make up any shortfalls using railroad-provided cars

UP's opening evidence addresses movements from the five PRB mines that originated coal to Montrose during the five quarters from January 2006 through March 2007. Mr. Fisher developed UP's variable costs using the URCS Phase III program and the data contained in the parties' Joint Submission of URCS Phase III Operating Characteristics. Mr. Fisher also used data identifying the percentages of shipper-provided and railroad-provided cars actually used for the complaint traffic, which UP produced in discovery in response to requests by KCPL.[8] In performing his calculations, Mr Fisher relied on UP and Western Region 2006 URCS unit costs.[9]

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8 *See* UP-KCPL-DVD 0021.

9 Because the Board has not yet released its version of 2006 URCS, UP created UP and Western Region 2006 URCS costs using standard Board procedures in rate cases, including an adjustment to include Account 90 and exclude Account 76, the 2006 UP, BNSF Railway, Kansas City Southern Railway, and Soo Line Railroad R-1 Annual Reports, and other public documents, including AAR's 2006 cost of capital calculation. *See* Electronic workpapers "06 FTI (continued...)

a) Operational Background

In this section, UP briefly describes how it operates KCPL coal trains between the PRB and Montrose.[10]

UP moved coal under the challenged rates from five different PRB mines to Montrose in the five quarters for which data were available at the time of the Board-ordered Joint Submission of URCS Phase III Operating Characteristics. UP moves coal from the PRB to Montrose in unit trains The trains typically consist of 115 shipper-supplied cars. Under the service commitment contained in the challenged tariff, however, UP is expected to address delivery shortfalls by shipping coal in railroad-provided cars.

UP supplies three AC locomotives operated in a 2x1 Distributed Power ("DP") configuration in both the loaded and empty direction between the Southern PRB and Montrose

At the mines, movement of the train during the loading process is performed by either a UP crew or a third-party loading crew, depending on the mine. The loaded train then moves from the mine to Bill, Wyoming, South Morrill, Nebraska, and North Platte, Nebraska, where it receives a 1,500-mile extended haul inspection and the locomotives are refueled. From North Platte, the train moves to Marysville, Kansas, and then to Kansas City, Kansas, where the train is parked at UP's 18th Street Yard. UP uses a minimum of four two-person crews for its portion of the movement from the PRB to Kansas City.

UMF.XML," "06 UP FTI.DAT," "06 FTI All Roads (Edited 7-18-2007) XML."

10 *See also* Union Pacific's Objections and Responses to Complainant's First Requests for Admissions, Interrogatories, and Requests for Production of Documents, UP Response to Interrogatory No. 7, which is included in UP's electronic workpapers. *See* Electronic workpaper "UP_Response7.pdf"

MNA uses a minimum of four two-person crews for its portion of the movement from Kansas City to Montrose and back. After the UP train arrives at 18th Street Yard, MNA adds one of its locomotives to the end of the train. (If MNA does not have a unit available, UP will supply one of its own locomotives.) The fourth unit is coupled to the locomotive already in place on the rear of the train, and is configured for multiple-unit service. The train departs in a 2x2 DP configuration via MNA trackage rights to Pleasant Hill and then continues to Nevada, Missouri, over the leased lines. The fourth unit is removed and placed in a siding by the MNA road crew, generally at either Ore, Missouri, or at Nevada, Missouri. Upon arrival at Nevada, the first MNA crew pulls the train past the turnout that connects the Ladue line to the Kansas City line. If the fourth unit is still on the train when it arrives at Nevada, it is uncoupled from the train and placed in a siding. The track configuration at Nevada does not allow for direct movement from the Kansas City line to the Ladue line or turning the train around, so the second crew does not change the configuration of the train and operates the train to Ladue with the single unit on the head-end and two units on the rear of the train.

At Ladue, the plant spur turnout does not allow direct movement into the plant; that is, the train approaches from the south but access to the plant is from the north Switching is required in order for the train to move into the plant. Upon arrival at the plant spur turnout, the train stops on the south side of the turnout and one of the crew members disembarks the train The second crew member moves the train forward until the crew member on the ground informs him that the train has passed to the north side of the plant spur turnout. The crew member on the ground at the spur turnout lines the turnout for the plant and then boards the locomotive that will now lead the train onto the plant spur. This is the end of the train with two locomotives The train proceeds through the plant spur turnout led by the two units and stops when the single unit on the rear of the train reaches the plant spur turnout. The crew member on the rear unit disembarks the locomotive and uncouples the locomotive from the train, and the train continues its movement towards the car dumper house Once the train clears the plant spur turnout, the second crew member lines the plant spur turnout for the mainline, boards the locomotive, and moves it through the spur turnout and onto the siding located on the south side of the spur track turnout. A crew van, provided by MNA, transports this crew member to the head-end of the train

When the train arrives at the dumper house, the MNA crew places an EOTD on the train in the event KCPL needs to stop the train in an emergency. The MNA crew advances the train for the first three cars that are dumped. The remainder of the train is dumped using the plant's indexing system.

In the empty direction, the third MNA crew is taxied to the plant and reassembles the train using the reverse of the movements that the previous crew performed on the loaded train prior to unloading. The third crew then takes the train to Nevada with one unit on the head-end and two on the rear of the train operated in DP configuration. At Nevada, the fourth crew moves the train to Kansas City with two units on the head-end and one on the rear operating in DP configuration. The MNA crew hands the train over to UP at Troost Avenue in Kansas City, Missouri.

After UP receives the empty train, the train moves to Marysville and then North Platte, where it receives a 1,500 mile extended haul inspection and car appliance inspection. Bad order cars are repaired in place or removed from the train. Upon completion of the inspection, the train is filled out to its target train size. All three of the inbound locomotives are replaced with a fully serviced and fueled set of locomotives.

Upon completion of the servicing of the train, the train moves to South Morrill, Bill, and then to the loading mine, where it begins the next cycle. UP uses a minimum of four two-person crews for its portion of the movement from Kansas City to the PRB

b) URCS Phase III Operating Characteristics

UP and KCPL have agreed on all of the URCS Phase III operating characteristics for each of the five mines from which KCPL received PRB coal in each of the five quarters from January 2006 through March 2007. The operating characteristics are listed in Attachment 1 to the parties' Joint Submission of URCS Phase III Operating Characteristics.[11]

Although UP's payment to MNA is not a Phase III operating characteristic, UP performed variable cost calculations that include the MNA payments also listed in the Joint Submission.

Finally, there is one factor on which the parties have not expressly agreed – the percentage of shipper- and railroad-supplied cars in those quarters in which both shipper- and railroad-supplied cars were used. UP's variable cost calculations are based on the percentages listed in Exhibits A and B [12]

2. Rates and Related R/VC Calculations

As discussed above, UP has performed variable cost and jurisdictional threshold calculations, by quarter for the first quarter of 2006 through the first quarter of 2007, using two methodologies – one that calculates UP variable costs using the Phase III program and treats UP's payments to MNA as a variable cost, and one that treats the issue traffic as if it were an interline movement with an interchange between UP and MNA in Kansas City and costs that

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11 *See* Electronic workpaper "Joint_Submission.pdf."

12 *See* Electronic workpaper "KCPL 1Q06-1Q07 Summary.xls "

movement using the Phase III program. The results of both sets of calculations are provided in Exhibits A and B. UP's workpapers include all of the underlying details.[13]

Respectfully submitted,

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Attorneys for Union Pacific Railroad Company

July 30, 2007

13 Electronic workpaper "jtl summary.xls."

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that on this 30th day of July, 2007, I caused a copy of Union Pacific's Opening Evidence to be served by hand on Kelvin J. Dowd of Slover & Loftus, 1224 Seventeenth Street, N.W., Washington, D.C. 20036

Michael L. Rosenthal

IV. WITNESS QUALIFICATIONS AND VERIFICATIONS

A. Benton V. Fisher

Benton V. Fisher is a Senior Managing Director at FTI Consulting, Inc., an economic and financial consulting firm with offices located at 1101 K Street, N.W., Suite B100, Washington, DC, 20005. Since 1991, Mr. Fisher has been involved in various aspects of transportation consulting including economic studies involving costs and revenues, traffic and operating analyses, and work with performance measurement and financial reporting systems.

Mr. Fisher holds a Bachelor of Science in Engineering and Management Systems from Princeton University. In 1991, he joined Klick, Kent & Allen, Inc , which was acquired by FTI Consulting, Inc. in 1998. While with KK&A and FTI, Mr. Fisher has performed numerous analyses for and assisted in the preparation of expert testimony related to merger applications, rate reasonableness proceedings, contract disputes, and other regulatory costing issues before the Interstate Commerce Commission, Surface Transportation Board, Federal Energy Regulatory Commission, Postal Rate Commission, Federal Court, and State Utility Commissions

Mr. Fisher is sponsoring evidence relating to Union Pacific's variable costs for the issue movement. His evidence is incorporated in Section II.A of the Narrative Mr Fisher has signed a verification of the truth of the statements contained therein A copy of Mr. Fisher's verification is attached hereto.

I declare under penalty of perjury that I have read the Opening Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct Further, I certify that I am qualified and authorized to sponsor this testimony

Executed on July 30, 2007

Benton V. Fisher

Benton V. Fisher

B. Robert J. Plum, III

Robert J. Plum, III, is a Managing Director at FTI Consulting, Inc., an economic and financial consulting firm with offices located at 1101 K Street, N W , Suite B100, Washington, DC, 20005. Mr. Plum holds a Bachelor's Degree in Accounting and an MBA degree with a concentration in finance. He began his career in 1979 with Wyer Dick & Company, a consulting firm that specialized in railroad costing issues. Since that time he has been involved continuously in analyzing accounting, cost, financial and engineering issues associated with railroad operations and pricing. He has conducted numerous variable and stand-alone cost studies, conducted and evaluated railroad contract provisions, field studies of railroad operations, and developed computer models to evaluate railroad engineering and operating requirements.

Mr. Plum is sponsoring evidence relating to Union Pacific's operations for the issue movement. His evidence is incorporated in Section II A of the Narrative. Mr. Plum has signed a verification of the truth of the statements contained therein. A copy of Mr. Plum's verification is attached hereto.

I declare under penalty of perjury that I have read the Opening Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony.

Executed on July 30, 2007

Robert J. Plum, III

C. Warren C. Wilson

Warren C. Wilson is Senior Director Rail Line Planning for Union Pacific Railroad Company His office is located at 1400 Douglas Street, Omaha, Nebraska, 68179. Mr. Wilson is responsible for Union Pacific's relationships with shortline and regional railroads, including Missouri & Northern Arkansas Railroad Company. Mr. Wilson has worked in the railroad industry for 38 years and in Union Pacific's shortline group since 1987. Prior to 1897, he held various marketing and operating positions with the Missouri Pacific Railroad and the Pennsylvania Railroad

Mr Wilson is sponsoring evidence in Sections I and II of this Narrative relating to Union Pacific's lease relationship with MNA. Mr. Wilson has signed a verification of the truth of the statements contained therein. A copy of Mr. Wilson's verification is attached hereto.

I declare under penalty of perjury that I have read the Opening Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony.

Executed on July 30, 2007

Warren C. Wilson

EXHIBIT

Jurisdictional Threshold Analysis for KCPL Movement, 1Q 2006 - 1Q 2007

— Based on Actual MNA Payment and UP URCS Loco & Fuel Costs for MNA Portion —

Quarter	Net Tons	Rate per Ton, incl Fuel Surcharge	% RR-Supplied Cars	Variable Cost per Ton	R/VC Ratio	Jurisdictional Threshold Level Rate
Belle Ayr Mine						
2006-Q1	147,365	$16 73	<1%	$10 78	1 55	$19 41
2006-Q2	96,114	$16 95	<1%	$10 93	1 55	$19 67
2006-Q3	222,766	$17 58	<1%	$11 01	1 60	$19 81
2006-Q4	193,915	$17 30	<1%	$10 77	1 61	$19 39
2007-Q1	108,019	$17 49	<1%	$10 96	1 60	$19 72
Black Thunder Mine						
2006-Q1	270,851	$16 73	<1%	$10 57	1 58	$19 03
2006-Q2	191,861	$16 95	<1%	$10 72	1 58	$19 29
2006-Q3	69,593	$17 58	<1%	$10 79	1 63	$19 42
2006-Q4	96,164	$17 30	14 3%	$10 72	1 61	$19 30
2007-Q1	84,147	$17 49	50 3%	$11 12	1 57	$20 02
Black Thunder South						
2006-Q1	68,870	$16 73	<1%	$10 40	1 61	$18 72
2006-Q2	96,657	$16 95	<1%	$10 61	1 60	$19 10
2006-Q3	83,238	$17 58	<1%	$10 72	1 64	$19 30
2006-Q4	55,222	$17 30	<1%	$10 50	1 65	$18 90
2007-Q1	40,606	$17 49	33 4%	$10 96	1 60	$19 72
Caballo Mine						
2006-Q1	52,084	$16 73	<1%	$11 03	1 52	$19 85
2006-Q2	27,807	$16 95	<1%	$10 91	1 55	$19 64
2006-Q3	42,079	$17 58	<1%	$11 04	1 59	$19 87
2006-Q4	55,665	$17 30	<1%	$10 77	1 61	$19 38
2007-Q1	121,461	$17 49	<1%	$10 99	1 59	$19 79
Jacobs Ranch Mine						
2006-Q1	13,881	$16 73	<1%	$10 54	1 59	$18 98
2006-Q2	95,044	$16 95	<1%	$10 79	1 57	$19 42
2006-Q3	53,655	$17 58	<1%	$10 94	1 61	$19 69
2006-Q4	69,937	$17 30	20 0%	$10 81	1 60	$19 46
2007-Q1	165,763	$17 49	24 2%	$11 00	1 59	$19 80

Jurisdictional Threshold Analysis for KCPL Movement, 1Q 2006 - 1Q 2007

— Based on 2006 Western Region URCS for MNA Portion —

Quarter	Net Tons	Rate per Ton, incl Fuel Surcharge	% RR-Supplied Cars	Variable Cost per Ton	R/VC Ratio	Jurisdictional Threshold Level Rate
Belle Ayr Mine						
2006-Q1	147,365	$16 73	<1%	$9 48	1 76	$17 07
2006-Q2	96,114	$16 95	<1%	$9 68	1 75	$17 43
2006-Q3	222,766	$17 58	<1%	$9 78	1 80	$17 60
2006-Q4	193,915	$17 30	<1%	$9 51	1 82	$17 11
2007-Q1	108,019	$17 49	<1%	$9 63	1 82	$17 33
Black Thunder Mine						
2006-Q1	270,851	$16 73	<1%	$9 27	1 81	$16 69
2006-Q2	191,861	$16 95	<1%	$9 47	1 79	$17 04
2006-Q3	69,593	$17 58	<1%	$9 55	1 84	$17 20
2006-Q4	96,164	$17 30	14 3%	$9 50	1 82	$17 10
2007-Q1	84,147	$17 49	50 3%	$9 99	1 75	$17 99
Black Thunder South						
2006-Q1	68 870	$16 73	<1%	$9 13	1 83	$16 43
2006-Q2	96,657	$16 95	<1%	$9 37	1 81	$16 87
2006-Q3	83,238	$17 58	<1%	$9 49	1 85	$17 08
2006-Q4	55,222	$17 30	<1%	$9 23	1 87	$16 61
2007-Q1	40,606	$17 49	33 4%	$9 76	1 79	$17 56
Caballo Mine						
2006-Q1	52,084	$16 73	<1%	$9 66	1 73	$17 39
2006-Q2	27,807	$16 95	<1%	$9 66	1 75	$17 39
2006-Q3	42,079	$17 58	<1%	$9 80	1 79	$17 64
2006-Q4	55,665	$17 30	<1%	$9 50	1 82	$17 10
2007-Q1	121,461	$17 49	<1%	$9 65	1 81	$17 38
Jacobs Ranch Mine						
2006-Q1	13,881	$16 73	<1%	$9 25	1 81	$16 65
2006-Q2	95 044	$16 95	<1%	$9 54	1 78	$17 17
2006-Q3	53 655	$17 58	<1%	$9 69	1 81	$17 45
2006-Q4	69 937	$17 30	20 0%	$9 61	1 80	$17 30
2007-Q1	165,763	$17 49	24 2%	$9 76	1 79	$17 57